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## Agenda Item 4b

June 14, 2011

### TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

- I. **SUBJECT:** AB 1247 (Fletcher) – As Amended May 9, 2011  
Financial and Investment Reporting Requirements
- II. **PROGRAM:** Legislation
- III. **RECOMMENDATION:** Support, with suggested amendments
- IV. **ANALYSIS:**

#### Summary

AB 1247 would modify the reporting requirements that were enacted last year as part of the 2010-11 budget package to instead require CalPERS to produce an annual report describing the investment return assumptions, discount rates, and amortization periods used to calculate contribution rates for State employee retirement plans. Specifically, the report must include a calculation of the contribution rates utilizing an investment return assumption of two percentage points above and two percentage points below the investment return assumption adopted by the Board. The bill would require the Chair of the California Actuarial Advisory Panel (CAAP) to report on investment return assumption and amortization period in the calculation of the contribution rates at a joint hearing of the Senate and Assembly committees on public retirement and the bill would delete the requirement that the Treasurer express his or her opinion of the reasonableness of the Board's calculation of the contribution rates. It also deletes the requirement of the Board to provide the Legislature with a revised calculation of the forecasted contribution rates utilizing a specified investment rate assumption.

#### Background

Existing law requires CalPERS to submit a report every time it adopts contribution rates for the State or contracting agencies that provide a description of the investment return assumption, amortization period, and discount rate and recalculate the contribution rates and liabilities using specified analytical guidelines. This report is submitted to the Legislature and Governor, and currently, the State Treasurer. The Treasurer, within 30 days following receipt of

the report, is required to report during a publicly noticed floor session of each house of the Legislature on the role that investment return assumptions and amortization periods have played on contribution rates, the consequences for future State budgets if the investment return assumptions are not realized, to report whether the amortization period exceeds the estimated remaining service periods of employees covered by the contributions, and to express his or her opinion of the reasonableness of CalPERS calculation of the contributions rates.

#### *Legislative Analyst's Office (LAO) Recommendations*

As part of their findings and recommendations on the 2011-12 budget, the LAO recommended that the CalPERS report on its investment returns, amortization period, and discount rates be based on more reasonable alternate investment return rates, focusing the reporting requirements on State plans instead of the hundreds of CalPERS local plans, requiring one report per year by CalPERS, and requiring an official other than the Treasurer to provide the independent analysis to the Legislature. The LAO suggested this independent entity could be one or more members of the California Actuarial Advisory Panel (CAAP). The LAO also recommended the Legislature consider requiring the report to be presented to the Legislature every two years and that instead of being presented to the full Legislature, the report be presented in a joint hearing of the two houses' budget and/or public employment committees.

#### *The California Actuarial Advisory Panel*

CAAP was established in 2008 and provides public agencies with impartial and independent information on pensions, other post-employment benefits, and best practices. The CAAP reports those recommendations to the Legislature on or before February 1 of each year.

The CAAP consists of eight actuaries, appointed by various public officeholders and agencies. The appointees generally serve terms of three years.

Under the law, the Governor appoints two of the panelists. In addition, one panelist is appointed by each of following:

- The California State Teachers' Retirement System
- The California Public Employees' Retirement System;
- The State Association of County Retirement Systems;
- The Board of Regents of the University of California;
- The Speaker of the Assembly;

- The Senate Committee on Rules.

### **Proposed Changes**

Specifically, this bill:

- Requires CalPERS to report annually rather than every time they adopt contribution rates.
- Limits the scope of the report to only apply to State employee retirement plans.
- Revises the investment return assumptions and discount rates CalPERS is required to use in the report to include a calculation of the contribution rates and liabilities utilizing an investment return assumption two percentage points above and two percentage points below the investment return assumption utilized by the board.
- Deletes the requirement that CalPERS report to the Legislature, utilizing a specified investment rate assumption, any time it forecasts contribution rates.
- Deletes the requirement that the Treasurer express his or her opinion of the reasonableness of CalPERS calculation of the contribution rates when reporting on the CalPERS report to the Legislature.
- Requires the Chair of the California Actuarial Advisory Panel to address a publicly-noticed joint hearing of the Senate Committee on Public Employment and Retirement (SPE&R) and the Assembly Committee on Public Employees, Retirement and Social Security (APER&SS) to provide an explanation of the role played by the investment return assumption and amortization period in the calculation of the contribution rates, a description of the consequences for future State budgets if the investment return assumptions are not realized, and a report on whether the Board's amortization period exceeds the estimated average remaining service periods of employees covered by the contributions.

### **Legislative History**

- 2010 Chapter 733 of the Statutes of 2010 (SB 867, Hollingsworth) – Requires the CalPERS Board of Administration, when adopting contribution rates, to provide an actuarial report, containing investment

returns, amortization period, and discount rates using specific analytical guidelines, to the Legislature, the Governor, and the Treasurer. The Treasurer, within 30 days of receipt of the report, must then address both houses of the Legislature about the report. *CalPERS position: None*

Chapter 371 of the Statutes of 2008 (SB 1123, Wiggins) – Among other things, established the eight-member California Actuarial Advisory Panel. *CalPERS Position: Support*

## **Issues**

### **1. Arguments in Support:**

According to the author, "AB 1247 improves the ability of decision makers and the public to evaluate the future funding status of State employee pension plans while controlling costs. This bill would provide more insight into how the State's contributions will change if the rate of return is better or worse than expected by requiring that estimates of future liabilities and contributions based on three possible rates of return be included in the pension system's annual report."

*Organizations in Support: None.*

### **2. Arguments in Opposition:**

According to the California Teachers Association, "The additional data that AB 1247 is attempting to gather is specifically designed to manipulate portions of the actuarial valuation to shorten the projected timelines for funding to create an inflated shortfall inconsistent with actuarial standards."

*Organizations in Opposition: California Teachers Association.*

### **3. CAAP Chair's Role**

The bill requires the Chairman of the CAAP to present an analysis of CalPERS investment returns before a joint hearing of the SPE&R and APER&SS committees. The CalPERS Chief Actuary, who serves on the Panel by Board appointment, is currently the Chairman of the CAAP. Therefore staff recommends the author consider an amendment that would allow the Chairman or designee to present information on CalPERS return on investments to the joint legislative hearing.

#### 4. Investment Return Rate Assumptions

Existing law requires the calculation of the contribution rates to utilize an investment return assumption based on the lesser of six percent per annum or one percentage point below the investment return assumption utilized by the Board and a calculation of the liabilities using a discount rate equal to the rate of the 10-year U.S. Treasury Note. AB 1247 would require these calculations to utilize an assumption two percentage points above and two percentage points below the investment return assumption utilized by the board.

While using two percentage points above and below the investment return assumption is better than the current requirement, it is still viewed as a dramatic change when looking at a 30 year assumption. Staff recommends that a more realistic approach would be to use an assumption of one percentage point above or below the investment return assumption utilized by the Board. Also, the calculation obtained from using one percentage point would provide a base of information that is easier for external parties to extrapolate to develop further projections and analyze alternate return scenarios.

#### 5. Legislative Policy Standards

The Board's Legislative Policy Standards indicate an oppose position on proposals which create unreasonable cost or complexity for the administration of the System. Since AB 1247 simplifies the current reporting requirements, staff is recommending the Board adopt a support position with the following suggested amendments:

- Calculate contribution rates and liabilities utilizing one percentage point above and below the investment return assumption instead of two percentage points.
- Allow the Chairman of the CAAP or designee present to the joint legislative committee.

### **V. STRATEGIC PLAN:**

This is not a product of the CalPERS strategic plan, but an ongoing responsibility of the CalPERS Office of Governmental Affairs.

**VI. RESULTS/COSTS:**

Program Costs

None

Administrative Costs

This bill would actually result in an administrative cost savings, since it reduces the workload required by the current reporting requirements.

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